ADMINISTRATION REQUEST FOR AN INCREASE IN THE PUBLIC DEBT LIMIT

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

TESTIMONY OF GEORGE D. GOULD, UNDER SECRETARY OF THE TREASURY FOR FINANCE

APRIL 30, 1987

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ADMINISTRATION REQUEST FOR AN INCREASE IN THE PUBLIC DEBT LIMIT

THURSDAY, APRIL 30, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The committee met, pursuant to notice, at 9:03 a.m., in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

[The press release announcing the hearing follows:]

[For Immediate Release Friday, April 24, 1987]

THE HONORABLE DAN ROSTENKOWSKI (D., ILL.), CHAIRMAN, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON THE ADMINISTRATION'S ANTICIPATED REQUEST FOR AN INCREASE IN THE PUBLIC DEBT LIMIT

The Honorable Dan Rostenkowski (D., Ill.), Chairman of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Committee will hold a hearing on an anticipated Administration request for an increase in the public debt limit. The hearing will be held on Thursday, April 30, 1987, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:00 a.m.

The current limit on the public debt of $2,300 billion will revert to $2,111 billion on May 15, 1987. This will make it impossible for the Federal Government to borrow from the public after May 15, 1987, to finance any current obligations or to roll over existing Treasury obligations which mature after May 15.

In announcing these hearings, Chairman Rostenkowski made the following statement: "It is critical that we pass an increase in the public debt limit by May 15. The obvious questions which need to be addressed in the hearing are: (1) By how much does the Administration wish to increase the limit; (2) By when must this bill be enacted; (3) Does the Treasury intend to increase it's cash balance on May 15 if Congress has not been able to pass a bill by that date; (4) Is any increase in the Treasury's authority to issue long-term bonds necessary; and (5) Does the Administration seek a clean bill or does it support changes in budget procedures (including Gramm-Rudman-Hollings) as part of this bill?"

Oral testimony will be heard from invited witnesses only. However, any interested individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS

For those who wish to file a written statement for the printed record of the hearing, six (6) copies are required and must be submitted by the close of business on Monday, May 4, 1987, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements may be furnished for distribution to the press and the interested public if supplied to the Committee office, 1102 Longworth House Office Building, before the hearing begins.

Chairman ROSTENKOWSKI. The committee will come to order.

This morning's hearing is on the administration's request for an increase in the public debt limit. The present law limit is $2.3 tril-

lion and will revert to $2.111 trillion on May 15. Without a further increase in the debt limit, it will be impossible for the Federal Government to borrow from the public or to roll over existing Treasury obligations which mature after May 15.

Furthermore, after May 15, there can be no savings bonds sales, no State and local government series sales, and no investment of new money for any trust fund, including the Social Security Trust Fund.

It is my intention, and I believe I speak for the entire committee, that the House pass a clean debt bill. It appears that a conference report on the budget resolution will not be voted on in the House before May 15. Consequently, we have to be ready to send a free standing debt limit bill to the floor.

The purpose of today's hearing is to obtain information regarding the current cash situation facing the Treasury Department. More specifically, we want to know when the Treasury will run out of money, and by how much do they seek to have the debt limit increased.

Under Secretary Gould, thank you for joining us.

Welcome to the committee. If you are ready, you may proceed.

STATEMENT OF GEORGE D. GOULD, UNDER SECRETARY OF THE TREASURY FOR FINANCE, U.S. DEPARTMENT OF THE TREASURY

Mr. GOULD. All right, sir. Thank you.

My purpose here today is to advise you of the urgent need for congressional action to increase the public debt limit. The current $2.3 trillion temporary debt limit lasts through May 15 and then reverts to the $2.111 trillion permanent ceiling. Since the actual debt subject to limit on May 16 will be about $160 billion above the permanent debt limit, beginning May 16, the Treasury will not be able to issue public debt securities to roll over maturing issues or to raise cash.

I want to emphasize the need for prompt action on the debt limit. The temporary debt limit expiring at midnight May 15 is different from the increases in permanent ceilings that had been enacted since 1983. There is no administrative flexibility to manage cash when the debt is well in excess of the permanent limit; no new Treasury securities can be issued and maturing issues must be redeemed as long as cash remains available. Disruptions in normal Treasury financing would begin May 16 when: trust and revolving fund investments and rollovers of maturing issues would be halted, resulting in lost interest for those funds; sales of savings bonds would be cut off and Treasury would have to notify 44,000 issuing agents to stop issuing savings bonds until further notice. In addition, sales of State and local government series nonmarketable securities would have to be stopped. Thus, we are requesting that Congress act to increase the debt limit prior to May 15.

On May 28, the United States will run out of cash, default on its debt and subsequently not be able to make June benefit payments. This is a new ball game which permits no playing around: the statutory ceiling drops back; there is no cash maintenance flexibility; and the effects of not acting are swift and damaging. Running out of cash means that the United States would default on its obliga-

tions, both domestic and foreign, with all the negative financial, legal and moral consequences that implies. In its over 200 year history, the United States has never defaulted on its debt obligations. To do so would be unthinkable and irresponsible. We would seriously erode this country's premier credit position and break faith with our citizens.

The Congress selected the May 15 date and adopted the temporary debt ceiling mechanism to assure that there would be no choice. The Congress has to act on new debt limit legislation to prevent the Government from running out of cash and defaulting on its obligations.

It has been suggested that the Treasury might alleviate some of the pressure of this debt limit crisis by overborrowing before midnight May 15 in an amount up to the limit before it collapses. We believe strongly that it would be inappropriate to do so, and therefore, will not. The reasons are clear. Such borrowings would be done only on the assumption of a failure to take necessary action on the part of Congress; an assumption that we are not prepared to make. Moreover, the market disruptions from large, unexpected borrowing would make such financing expensive and have a negative economic impact. Furthermore, our estimates indicate that even with overborrowing, the Treasury will default on its debt obligations and be unable to make benefit payments beginning on June 1.

As to the amount of the increase in the debt ceiling, we request that Congress raise the ceiling to either: $2.8 trillion, an amount sufficient to be sure to get through May 1989, when the Congress will have had a chance to act on fiscal year 1990 budget resolution; or $2.578 trillion, the amount estimated in the President's Budget to be necessary for fiscal year 1988, with the Treasury's conventional assumption of a $5 billion allowance for contingencies.

We believe the first option is preferable in order to remove the burden of dealing with the time consuming debt limit issue in the midst of election year schedules.

BOND AUTHORITY

Mr. Chairman, I would like to take this opportunity to advise you of the need for legislation to provide additional authority to issue marketable Treasury bonds. The maximum interest rate that the Treasury may pay on marketable bonds, defined as securities with maturities in excess of 10 years, has long been limited by law to 4.25 percent. This limit did not become a serious obstacle to Treasury issuance of new bonds until the mid-1960's. At that time, market rates of interest rose about the 4.25 percent rate and the Treasury was precluded from issuing new bonds. The average length of the privately held marketable debt of the Treasury declined steadily at that time from 5.75 years in mid-1965 to about 2.5 years in 1975 because of the heavy reliance by the Treasury on short-term bill financing of the budget deficits during this period.

In 1971, Congress authorized the Treasury to issue a limited amount of bonds without regard to the 4.25 percent interest ceiling. The dollar limit since has been increased from time to time, most recently on April 7, 1986, when the limit was raised by $50 billion,

from $200 billion to $250 billion, to accommodate additional long-term financing.

Assuming continuation of our recent pattern of long bond issuance, the existing $250 billion authority will be sufficient for new Treasury bond issues only through the August 15, 1987 regular mid-quarter refunding.

Since 1975, the Treasury's debt extension policies have moved the average length of the marketable debt from 2 years and 5 months in January 1976 to 5 years, 6 months in March of 1987, thus broadening the market for Treasury securities and reducing the administrative burden and market-disrupting effects of frequent Treasury operations to refund maturing issues. Yet, while the Treasury has significantly improved the maturity structure of the debt in recent years, more than half of the outstanding marketable debt matures within 2 years. This refunding requirement must be added to Treasury's new cash borrowing requirements to meet Treasury's total needs in the market. Because of the short maturity of a large proportion of outstanding Treasury marketable debt, long bond issuance must remain an integral part of the Treasury's debt management policy.

The 4.25-percent ceiling should be repealed. This interest rate ceiling is an ineffective way to control prices and is incompatible with our commitment to a free market pricing system. We view the interest rate ceiling on marketable bonds as an anachronism which serves only to frustrate the efficient management of the public debt. Removal of the 4.25-percent ceiling on Treasury marketable bonds will help the Treasury meet its financing needs in an efficient, cost-effective manner.

However, if the interest rate ceiling on long bonds is not abolished, as we believe it should be, we would request an increase in long bond authority of $75 billion, from $250 billion to $325 billion.

TRUST FUND INVESTMENTS

There has also been a great deal of controversy in recent years regarding noninvestment or disinvestment of trust funds to make room for market borrowing to raise cash needed to pay benefits. Two approaches to resolving the issue were advanced last year. Under the first option, legislation would be enacted to require the Secretary to disinvest the trust funds in amounts sufficient to assure that cash could be raised through market borrowing to pay benefits in a timely fashion, and subsequently to restore any interest losses. The second option would be an outright statutory prohibition against disinvestments under any circumstances.

We believe it is important to have this issue resolved one way or the other, so as to clarify responsibilities. We prefer the first option, with its greater reassurance to trust fund beneficiaries. This was done for the civil service retirement and disability fund in the Budget Reconciliation Act of 1986. I want to emphasize, however, that if the Government is unable to raise cash because the debt substantially exceeds the limit, as will be the case after May 15 unless Congress acts, benefits could not be paid even if trust funds were disinvested.

CONCLUSION

The expiration of the temporary debt ceiling triggers disruption of Treasury financing immediately and a subsequent cash default on May 28 in the absence of new debt limit legislation. The consequences of a debt limit crisis and default would be to jeopardize the U.S. credit standing in the world. The Treasury's ability to fund the deficit would be threatened and the costs of Government to the U.S. taxpayer would greatly increase. The administration therefore requests that the Congress enact a debt limit by May 15. We do not support adding provisions that could imperil prompt passage of this urgently needed debt extension.

This concludes my prepared statement, Mr. Chairman, and I will be happy to answer any questions.

Mr. GIBBONS [presiding]. Mr. Secretary, I have a number of questions I would like to ask you. If Congress does not increase the debt limit by May 15, how much time will remain before the Treasury can no longer finance its current operations?

Mr. GOULD. Well, again, I would like to emphasize, Mr. Chairman, that this year has a different pattern from prior years because Congress has enacted a revision downward in the ceiling immediately on May 15. That eliminates some of the so-called flexibility that existed in other years.

Let me try to sketch the main problems for you, between May 15 and May 28, the absolute date on which we run out. We will go into the period after May 15 with a substantial cash balance. But on May 21, a Treasury bill comes due, if I recall correctly on the order of $14.7 billion. Because we cannot sell new Treasury bills to refinance the maturing issues, we will have to pay that down in cash. That will, then, absorb a major portion of our remaining cash.

As we go through the next week, as is our usual pattern, we come to the following Thursday, May 28, when another Treasury bill comes due. By a wide margin, we will be unable to pay down that Treasury bill because the amount of it will exceed all our existing cash resources. And at that point, we will have an absolute default.

Mr. GIBBONS. Have you estimated how much it would cost the Treasury if Congress is unable to meet the May 15 deadline and how much it would cost if we are still unable to meet the May 24 deadline?

Mr. GOULD. May 28, sir.

Mr. GIBBONS. The May 28 deadline.

Mr. GOULD. The cost of the disruptions on May 15 are a little hard to quantify, in respect to what damage results from shutting off the savings bond program. The savings bond program has been a very efficient way for this Government to finance, as well as providing for small savers an outstanding variable rate interest vehicle.

Many or most savings bonds are sold through payroll deductions. We have enlisted many companies to push this plan for us. When you have such a plan working, it is hard to calculate what happens when you interrupt it. But you do know that it is a bad result.

I cannot put a price on it for you, but it is the type of thing which disrupts years of work in trying to put it in place. The State and local series obligations, so-called SLGs, operation would be disrupted. It is a well-synchronized financing mechanism that has been in place and in many respects such a disruption makes the Government appear unable to fulfill its previously stated positions and obligations.

Mr. GIBBONS. So we can safely say it does cost a substantial amount of money?

Mr. GOULD. Yes.

Mr. GIBBONS. If we miss the 15th deadline, and if we miss the 28th, we have got a disaster, is that right?

Mr. GOULD. Well, sir, it is almost hard to articulate the cost of a default on May 28. We, at the present time, have seen an increase in interest rates. The interest rate increase that could result from a default on the full faith and credit obligations of the U.S. Government is almost incalculable.

The ripple effect of that, in terms of agency securities, in terms of the default of institutions, in terms of the view that would be held of us abroad, adds up to a cost that I would say again, you could not pinpoint, but I would think it could run, over a period of time, into the hundreds of billions of dollars.

I might also, if I may, just point out that there is an unusual occurrence also on May 21. We cannot find anyone in the Treasury that can remember when we actually paid down a Treasury bill rather than selling a new one to refund it.

Now while that does not result in a default or anything of that sort, as much as 80 percent—according to our numbers—of maturing Treasury bills held by small individuals in our so-called Treasury Direct program are rolled over. Here we are going to have a situation where people who have looked at this mechanism as a savings procedure will be unable to roll their money over in U.S. Treasury obligations and will instead receive a check through the mail and really will not understand what has occurred here. So it is not a technical default, but it is troubling.

You might not have explicit costs, but it is the first time in anyone's memory in our organization that this has ever occurred, and I just do not think we need a lot of disruptions in the present environment.

Mr. GIBBONS. Mr. Secretary, it seems inevitable that the Senate will not pass a clean debt bill. There is widespread speculation that certain amendments will be attached to the bill, that amend Gramm-Rudman-Hollings. These amendments are highly controversial and could extend debate for a significant period of time.

My question is this: how determined is the administration to pass a clean debt bill and how far is the administration willing to extend itself to ensure the passage of a clean debt bill?

Mr. GOULD. We are totally committed, sir, to a clean debt bill. The consequences of May 28, I think, speak for themselves and we will go, as the Treasury and the administration, to whatever efforts we have to, to ensure the passage of a bill by that date.

Mr. GIBBONS. Of the possible amendments to Gramm-Rudman, would the administration support the reinstatement of the automatic trigger vesting this authority with OMB?

Mr. GOULD. I cannot say that I am personally familiar with what you are asking.

Mr. GIBBONS. As you know, in Gramm-Rudman, there was an automatic trigger that required that if we did not hit the target, it would be turned over to the Auditor General, Comptroller General. Now, I am asking you would the administration support a Gramm-Rudman bill where the automatic trigger control was vested in the Office of Management and Budget?

Mr. GOULD. Well, I think the administration's position is really quite straightforward in the sense that we do not support anything being attached to the debt bill that would endanger the enactment, ideally by May 15, but under no circumstances later than May 28. I think it would be a proper statement to say that whatever the nature of an amendment might be to this bill, to the extent that it is controversial and could impede the progress of a debt ceiling increase, we will be opposed.

Mr. GIBBONS. Suppose you get one anyway, would you veto the debt ceiling increase?

Mr. GOULD. I cannot speak for the President, Mr. Chairman, but I think the evidence——

Mr. GIBBONS. You might speak to him and get him thinking about it, because that may happen. I think we can get a clean debt ceiling out of the House, with the cooperation of the Rules Committee, of course, and all of our members. It takes a lot of cooperation, but we have been able to do that.

I do not think we can do it in the Senate, because of the way the place operates. I am just trying to get some of these contingencies out so that we can look at them now and get you positioned to handle them perhaps a little better.

What are the Treasury's contingent plans, should Congress not increase the debt limit by May 15?

Mr. GOULD. Again, this being a different year from other years, there really are not any contingencies. On May 15, we interrupt State and local series issuances, we interrupt savings bonds. But on a cash basis, we can continue to meet our obligations in the debt market and meet maturing obligations, and we can continue to pay our bills until we run up against an enormous deficit in our ability to do so, on May 28.

The size of our shortfall is so large that there are no contingencies which would have any impact.

Mr. GIBBONS. So what you are saying, in short, is that anyone who rests upon the experience that we had in past years, where when we passed the debt ceiling limits like May 15, the Treasury could coast on and did coast on for quite some time. People are using a wrong experience rating to judge what will happen now, because of the snapback effect of the temporary ceiling?

Mr. GOULD. Yes, sir, I think that is just the way to put it. The experience this time will be different.

Mr. GIBBONS. And the administration intends to be very hard nosed and perhaps even veto a debt bill ceiling that has riders on it. Is that right?

Mr. GOULD. You really get pushed against the rock very hard on May 28. It is such a catastrophic event for this country, and for the people of this country, and indeed for the world financial system,

that not to have a debt ceiling increase on the 28th, to me personally, is unthinkable.

But we do come up very hard against that particular date and again, while I cannot speak for the President in terms of veto, the consequences of not having a debt ceiling increase on that date are almost incomprehensible.

Mr. GIBBONS. Mr. Gould, what I am talking about is all 100 Members of the Senate know that and all of them have got their pet bills over there and they have no rules, and they operate under unanimous consent and senatorial courtesy, and they are going to hang everything but the kitchen sink on this debt ceiling, trying to make you swallow it.

You are going to have to say very determinedly you are going to swallow it, or you are going to have to say very wishy-washy that you are going to negotiate with them. You are going to have to make up your mind. The President is going to have to make up his mind. As I say, I think and I hope we can get a debt ceiling out of the House without a lot of garbage on it, but when you get to the Senate, it is not going to be that easy and you are going to have to face up to it.

Well, let us see, Mr. Frenzel, you were the next on this morning.

Mr. FRENZEL. I do have a question, Mr. Chairman.

I thank the Secretary for his testimony today.

How much of our debt, roughly what percentage, is held offshore?

Mr. GOULD. Approximately 12 percent.

Mr. FRENZEL. Approximately 12 percent?

Mr. GOULD. Yes, sir.

Mr. FRENZEL. And how much was held offshore 2 years ago?

Mr. GOULD. That number has hardly changed over a long period of time.

Mr. FRENZEL. What is a long period of time, 10 years?

Mr. GOULD. I would think 8 years.

Mr. FRENZEL. Lately you have had to pay a little higher rate of interest in your offerings. Would you be in better shape if you sold yen bonds in Japan, for instance?

Mr. GOULD. Well, I think it would depend, sir, on how you define in better shape. On a current interest basis——

Mr. FRENZEL. Would you get a better rate?

Mr. GOULD. On a current interest basis one could get a better rate. There is something on the order of 500 basis points difference between the interest rate on our 10-year security and the interest rate on a Japanese 10-year security. However, ultimately whether that is a cost-efficient way of financing will depend upon currency fluctuations, because if you sell them in yen you must pay off the principal and the interest in yen and you would have to go out 10 years and look back before you would really know whether or not you have saved money for the taxpayer by financing in foreign currency.

Mr. FRENZEL. So you would have to make an estimate on what changes would be over the next decade to determine the lowest net cost?

Mr. GOULD. Yes, sir.

Mr. FRENZEL. But there are other values to selling abroad, are there not? Did we not sell debt instruments denominated in European currencies in the mid-1970's?

Mr. GOULD. Yes, if I recall, the date of the so-called Carter bonds, I think they were 1978, 1979, and 1980.

Mr. FRENZEL. 1978. I thought we had sold some earlier than that, under Secretary Connally. Is that not true?

Mr. GOULD. It may have been true, but I do not recall them.

Mr. FRENZEL. And those, can you tell us how those look in retrospect? Were they any good for the taxpayer?

Mr. GOULD. I think there are a number of issues involved in a foreign currency denominated bond, one of which—and a very important factor—is the ultimate cost efficiency. But I think that the proposal to use this in ways to attempt to affect the currency, and if you will recall, during the Carter period we also had rather violent turns going on in the currency markets, is an issue that is open to debate.

For example, if we were to sell yen bonds now, and that suggestion has been made to us from a number of sources, one of the thoughts is that we should use it as a war chest of yen for intervention. Even assuming that were a desirable goal, to have such a war chest, there are other ways to do that that could be more efficient and did not expose us in the same way.

It could also be viewed as a sign of weakness, that we are unable to finance the American debt except by using foreign currency.

Mr. FRENZEL. Is that not a fact?

Mr. GOULD. No, sir, I do not believe that to be a fact at all.

Mr. FRENZEL. As I understand, much of the suggestion is made that the weakness in the bond market reflects a disinvestment from abroad and that yen denominated bonds would be more attractive and might shore up a hole that has been apparent in the last 3 weeks. Would you take exception to that conventional Wall Street wisdom?

Mr. GOULD. I am not sure that is the conventional Wall Street wisdom. I have read articles in periodicals to that effect, but we have an advisory group of 20 of the leading Wall Street dealers and bond experts who we meet with at our financings. We just announced our quarterly financing yesterday, and I have just finished 2 days of meetings with that group, and that is not their perception at all, nor is it our perception.

I would argue, interestingly, that one of the single biggest worries in the bond market at the moment has to do with protectionism in the trade bill. If you want to go back and look at the last part of the steepest decline in our bond prices, it correlates very well with the growing concerns over what the trade bill would do. It is an open-ended worry, what it would do to the currencies.

I think that there is a risk factor or a risk premium, to be technical, built into our loan rates now which concern as much currency and trade as they do whether or not the Japanese are going to be involved in our auction.

Now we are going to test the theory for you. Next Thursday we auction $9¼ billion of 30-year bonds, following two earlier auctions on Tuesday and Wednesday in an aggregate amount for the three issues of $29 billion. I am convinced we will have a successful auc-

tion. I cannot tell you whether the Japanese will or will not participate, but I will suggest very strongly that we will have a successful auction whether they participate or not.

The American debt market for Government securities is very broad within this country. It is also broad beyond this country, and at any given point of time, the interest of investors shifts from one group to another. But the market is so broad that we do not feel we are dependent upon any one specific group of investors.

Mr. FRENZEL. Thank you very much. Mr. Chairman, my time has expired.

Mr. GIBBONS. Mr. Coyne.

Mr. COYNE. No questions.

Mr. GIBBONS. Mr. Jacobs.

Mr. JACOBS. Mr. Gould, you just said that you are confident that the success of your auction will not depend on Japanese participation. Would it be correct to say—would you extend that to say it would not depend on foreign participation, or just Japanese participation?

Mr. GOULD. It again is not dependent upon, as I say, upon any one group. The Japanese, perhaps because of the enormous size of their surplus, are looked at as a sort of bellwether. And the Japanese, indeed, have been substantial investors in various facets of the American economy in recent years.

There are lots of American institutions——

Mr. JACOBS. We are straying here. I said, would you include in that group all foreign investors. Would you say the auction would be successful without foreign investors?

Mr. GOULD. Yes. Ideally, you want as many people as possible interested in your issue at the time of issuance because that denotes the lowest possible interest cost you can get. So successful—we will sell them. That is my definition of success. Whether we will pay a few basis points higher because one group or another is not involved, perhaps.

Mr. JACOBS. What about foreign investors as a group?

Mr. GOULD. Foreign investors as a—if you are talking, sir, about the ability to sell our bonds, we are not dependent upon foreign investors as a group.

Mr. JACOBS. Fine. Now, if that is true, why are you willing to pay so much higher interest to foreign nationals than you do our own citizens who purchase these bonds?

Mr. GOULD. In what respect, sir, do we pay them more?

Mr. JACOBS. In respect to your somewhat unpublicized success in repealing the taxation, the U.S. Federal income tax on foreign nationals who earn interest on investments in the deficit of the U.S. Government.

Mr. GOULD. Well, I think that involves a broader issue than merely the issuance of our Government debt.

Mr. JACOBS. Is it not a fact that about a year ago representatives of the Treasury were here speaking to our staff about reinstating the 30-percent withholding for everything but the issuance of the public debt instruments?

Mr. GOULD. I was not part of that group so I cannot speak about a meeting that I did not attend.

Mr. JACOBS. Would you favor a——

Mr. GOULD. No, sir, we would not.

Mr. JACOBS. How about just for the public offerings? You favor continued advantage to the foreign national in buying the U.S. Government bonds over an American citizen?

Mr. GOULD. I am not sure, sir, that I would characterize it that way.

Mr. JACOBS. I would.

Mr. GOULD. I assume that foreign nationals pay taxes in their country, and our citizens who buy our bonds pay taxes in this country.

Mr. JACOBS. That was true before you got the repeal of the 30-percent withholding, was it not?

Mr. GOULD. It is true that American citizens pay taxes on the interest or gains from the purchase of American securities. Foreign taxpayers pay tax wherever they are subject to tax.

Mr. JACOBS. But until you got it repealed in 1984 the foreign person, foreign national who purchased a U.S. bond had to pay Federal income tax to the United States along with the American citizens who purchased the bond, just as the boxer from Brazil had to pay U.S. income tax on the money that he made here. Is that not right?

Mr. GOULD. Yes. To what extent the foreign purchaser would have a chance to get a refund of his withholding tax based on his overall tax situation, I cannot tell you. But we are, in a broad sense, very committed to free capital flows around the world. We do not think the modern world can work without them, and we do not favor things that impede the flow of capital, particularly if it were to occur in ways that made, not merely our Government securities market but investment in America, generally less attractive.

Mr. JACOBS. But even though you will not characterize it in your own words as the foreign national receiving, in effect, a higher interest rate vis-as-vis money earned in the United States than an American citizen who buys the same kind of bond, it is still in essence true, is it not?

Mr. GOULD. Sir, I do not think it is quite that simple. If you worked for General Motors and you were the beneficiary of the General Motors pension fund, you would not have to pay taxes on the interest the fund received on American securities. I do not think that is a discrimination.

Mr. JACOBS. Wait a minute. Before 1984, if I were a Japanese businessman and bought a $1 billion bond from the U.S. Treasury I would be subject to the 30-percent withholding on the interest I received from it, would I not?

Mr. GOULD. I do not know, sir, whether you are arguing that we ought to double tax foreigners or whether——

Mr. JACOBS. Never mind my argument, let us concentrate on my question. Is that true or not?

Mr. GOULD. There was a period of time in this country when there was a withholding tax on foreign investors, yes, sir.

Mr. JACOBS. And that was right up to the so-called Deficit Reduction Act of 1984.

Mr. GOULD. That I do not recall, but there was in earlier times in our history such withholding taxes.

Mr. JACOBS. 1984 is not too far back in history. You are still in office and that was an election year so it cannot be too long ago. It has got to be less than 4 years, does it not—more like 2.

Mr. GOULD. Yes. I am sorry sir, I think I have lost the trend of your question.

Mr. JACOBS. Up until 1984 or 1985, whenever that took effect, the foreign national who made money in the United States had to pay income tax along with all the rest of us in the United States before you got the 30-percent withholding repealed. And you did not do it up front, it was done in conference and I doubt if 5 percent of the members of Congress even knew it was in the bill when they voted on it.

The other question I wanted to ask, Mr. Gould, is about the administration's position on disinvestment of the Social Security trust fund. I take it that your argument is that the Social Security beneficiaries themselves benefit from disinvestment, once the deadline has passed for the debt limit and the U.S. Government can spend no more; is that correct?

Mr. GOULD. Well, the issue I think is—and it has been a difficult issue—is the money in the trust funds there primarily for the purpose of paying the beneficiaries. And therefore, if there is money available there in a way that can be translated into cash for those payments to beneficiaries, that is probably the proper first priority.

Mr. JACOBS. Now if we do not prohibit disinvestment, it is really at the discretion of the administration as to whether York missiles will be paid for or whether Social Security obligations will be paid for with that disinvestment, is it not?

Mr. GOULD. No, sir, we have never disinvested the trust funds for any purpose other than paying beneficiaries.

Mr. JACOBS. Now again, that was not the question. I am not asking——

Mr. GOULD. I am having a little trouble hearing you, sir, if I may say so.

Mr. JACOBS. My point is, I am not asking what you have ever done, I am asking what you could do, as far as the statute is concerned, if it allows—if it continues to allow disinvestment.

Mr. GOULD. I cannot personally answer that question. I cannot tell you what the nature of the statute—whether it is silent on the use of it or what. I simply do not know, sir. But I know as a matter of policy since I have been at the Treasury that we would never have disinvested the trust funds for any other purpose.

Mr. ARCHER. Will the gentleman yield?

Mr. JACOBS. Sure.

Mr. GIBBONS. His time has about expired. We will come back over to——

Mr. JACOBS. I ask unanimous consent to proceed for 1 minute, and yield to the gentleman from Texas, so I will still have a minute to get my answer.

Mr. ARCHER. I am sorry, I did not realize you were awaiting an answer. But this will be very quick.

Mr. Gould, what is the last possible date that this debt ceiling situation has to be resolved in order for you to be able to pay the June 1 Social Security benefits?

Mr. GOULD. If you were to—we would default—I am not sure I know exactly how you are characterizing that, sir. We will default——

Mr. ARCHER. If the Congress does nothing and the existing law continues, how long can it continue? And at what point does the debt ceiling have to be raised in order for you to pay the June 1 Social Security benefits?

Mr. GOULD. We have to have a debt ceiling increase in time to raise money for the payment of the Treasury bills, or the ability to roll over and sell new Treasury bills to pay off the old Treasury bills on May 28. There is absolutely no give because when the debt ceiling reverts on May 15 it goes down $160 billion. That removes all flexibility that might have been exhibited in the past. There is no way to disinvest the Social Security——

Mr. ARCHER. No, I understand your answer there. But I am asking you what is the last possible date that this can be resolved in order to pay the June 1 benefits? I am not asking you about rolling over your outstanding debt or anything else. I am talking about the payment of the June 1 Social Security benefits.

Mr. GIBBONS. His answer is May 28.

Mr. GOULD. That is right.

Mr. GIBBONS. He said that a number of times before you arrived. May 28 is the deadline. We go belly-up on May 28.

Mr. ARCHER. But the checks are not due until June 1, Mr. Chairman.

Mr. GIBBONS. We do not have any money.

Mr. GOULD. We do not have any cash, sir. We are in default.

Mr. GIBBONS. We are in default.

Mr. ARCHER. But if we resolve this on the 31st of May, even though you are in default on your other obligations, will you then be able to pay your June 1 Social Security checks?

Mr. GOULD. Sir, we would have to go out and raise cash. And our ability to raise cash, having been in default for a few days—I suppose at some price you could raise cash. But it would be a chaotic financial market that we would then be dealing with.

Mr. ARCHER. No, I understand all that. I am asking only relative to the payment of the June 1 Social Security checks. I understand all the rest of this is a major big problem. But relative only to the payment of the Social Security checks, when do you have to have this resolved in order to be able to have the June 1 Social Security checks go out?

Mr. GOULD. We would have to have it resolved in time to raise cash on the open market so that the checks could be cashed.

Mr. ARCHER. So you cannot give me a date?

Mr. GOULD. Yes, I could give you a date of the beginning of June. But that does assume that I am able to go out into the market and finance having just defaulted a couple of days previously.

Mr. ARCHER. Thank you.

Mr. GOULD. I find it rather theoretical, sir.

Mr. ARCHER. Thank you very much.

Mr. JACOBS. If I can just take my last minute.

Mr. GIBBONS. You have 30 seconds.

Mr. JACOBS. I think I have a minute if you had 10 minutes, Mr. Chairman.

Mr. GIBBONS. All right.

Mr. JACOBS. But my question is, when the gentleman from Florida said, when midnight strikes and Cinderella turns into a Honda or whatever, the thing goes belly-up. You cannot pay anything anymore, is that not right? Under the Constitution, is there any authority to pay anybody or anything when the debt limit has arrived and cannot be exceeded?

Mr. GOULD. There is a difference between cash and the debt limit. We cannot sell any more Treasury securities.

Mr. JACOBS. I understand all that. But I am saying, when you get to the point where there is not any money, you cannot pay anybody, right?

Mr. GOULD. That is correct, sir.

Mr. JACOBS. Then how is it that the President announced when he sent all these Federal workers home that he would keep the essential ones, including the one who did his strawberries at breakfast over at the White House? How could they pay them?

Mr. GOULD. I cannot answer that, sir.

Mr. JACOBS. No, I do not believe anybody can.

Mr. GIBBONS. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I think it was a little bit unfair of the gentleman from Indiana chastising you about whether or not——

Mr. GOULD. I am having trouble hearing you, sir.

Mr. DUNCAN. I say, I think it was a little unfair of the gentleman from Indiana when he chastised you about the tax because whether or not you tax or do not tax on foreign sales, it is entirely within the jurisdiction of this committee.

Could we have order, Mr. Chairman?

Mr. GOULD. Yes, there is such background noise, sir, that I simply cannot hear.

Mr. DUNCAN. My statement was that I thought it was a little unfair about the gentleman from Indiana chastising you about whether or not you tax or do not tax, and that issue is certainly within the jurisdiction of this committee and also the Congress of the United States.

Mr. JACOBS. Since the gentleman mentioned my name, would you yield just for a second?

Mr. DUNCAN. Be glad to.

Mr. JACOBS. I asked the administration whether they would favor reimposition of the tax. They are responsible for their opposition to that, are they not?

Mr. DUNCAN. But your statement was that you were chastising him for enacting a tax which he had nothing to do with.

Mr. JACOBS. That is not in evidence.

Mr. DUNCAN. But anyway, last year this committee reported legislation that would have prohibited disinvestment. I certainly hope we exercise our responsibility this year, and that it will not be necessary to even look at the issue of disinvestment.

And I, for one, would vote for a prohibition this year, and I am certainly hopeful that we do not have to go through the agony of that uncertainty again this year.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Any further questions?

Mr. GREGG. Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Gregg.

Mr. GREGG. Yes, I was wondering—you may have discussed this before I arrived but I would still like to understand it. I note that you say that because of the new tax act and the effect that may have on revenues, that you cannot predict when you are going to run out of cash, but that under any event you are going to run out of cash on May 28.

Mr. GOULD. Yes, sir. There is a sufficient shortfall on that date due to the maturing of a Treasury bill that there is no doubt that we cannot make it through.

Mr. GREGG. I find that very hard to believe. You receive almost all the income tax receipts of the Federal Government in April, right? April 15 you receive a huge amount of money. What are you estimating—how much do you estimate you are going to receive in April—as of the April 15 filing?

Mr. GOULD. I would think there is a chance that by April 30 our cash balance would be on the order of $50 billion.

Mr. GREGG. What, historically, has the cash balance been on April——

Mr. GOULD. That is somewhat higher, I believe, than what we have had historically.

Mr. GREGG. And the note that is due on the 28th exceeds that, less whatever the current expenses are?

Mr. GOULD. We have to pay the current expenses of the Government. We have to pay off a maturing Treasury bill on the 21st of May on the order of $14.7 billion. And we have to pay a variety of things between the end of April and the 28th. Our projections show that Treasury bill maturing May 28 exceeds the cash we will have to meet that payment.

Mr. GREGG. All right. And in the area of disinvestment, the Social Security fund is now running a significant surplus and is continuing to build up surpluses. Has that affected the estimates at all? Does that have any impact on the estimates?

Mr. GOULD. The estimates of when we——

Mr. GREGG. Whether or not you will be able to pay Social Security checks, or whether or not you can disinvest?

Mr. GOULD. No, sir, not in this instance.

Mr. GREGG. And why is that? I would like for you to explain that.

Mr. GOULD. Perhaps let me try to walk through the disinvestment process briefly. We put into the Social Security fund special issues of Treasuries, the terms of which are provided by law. We usually invest the money on the first of the month—there is a procedure called normalized tax transfer. I do not want to get further than you want to get into this.

But you invest and then you disinvest as the checks come in, and the pattern averages out to a 10-day basis, so we are computerized for that. And we disinvest and we use the money that we disinvest to pay benefits.

Now you cannot issue Government securities when the debt limit is below the amount of the securities outstanding, as in this case when we will be at about $160 billion above. So the amount of money in the trust fund is not really as significant as the fact that

we are unable either to issue securities into the Social Security trust funds to provide investment income to them, or to sell securities to raise cash.

What we are talking about in this instance is the inability to have either newly sold securities, or to have cash in our checking account. We get a double whammy. We are out of cash and we have no ability to sell securities or invest the trust fund.

Mr. GREGG. I take it, therefore, that the special securities issued to the trust fund, which the trust fund presently holds are not salable on the open market?

Mr. GOULD. Yes. They are special nonmarketable issues.

Mr. GREGG. Thank you.

Mr. RUSSO. Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Russo.

Mr. RUSSO. Mr. Secretary, I would like to follow up on that line of questioning. Let me explain the problem I am having. You have a surplus in a fund which is paid for out of payroll taxes, which is a separate tax operation and the money is allocated to this trust fund and it generates a surplus. If you did not invest it and make money on the money—assume we did not do that—you would have the surplus sitting in the Social Security fund to pay its recipients.

Why if you invest it, will you have less money available then if you did not do anything with it? I don't know if I made myself——

Mr. GOULD. You mean less money available to pay——

Mr. RUSSO. As I understand the way Social Security works, the payroll taxes go into this separate, Theoretically, it goes into a separate, Social Security trust fund.

Mr. GOULD. Yes. What we do is collect general revenues into the Treasury. There is a normalized tax transfer in which we estimate the amount of money that should be put in the trust funds each month and we put that in. And there is a kind of evening up process at the end of a year looking backwards as to what amount of interest is properly payable to the funds.

So we basically, if you want to look at it this way, we basically pay the Social Security benefits out of the general funds of the Treasury, but the payroll taxes are allocated to the fund.

Mr. RUSSO. Okay. As I understand the way the surplus works, I mean obviously you have more money coming in than you are paying out to beneficiaries; is that a fact?

Mr. GOULD. Yes, although the surplus that is talked about is not that enormous yet.

Mr. RUSSO. How much is it, $20 billion a year?

Mr. GOULD. I could not give you an offhand amount. But when you look on a month-to-month basis the collections have, until very recently, been just about the payments out on a current basis.

Mr. RUSSO. In the last fiscal year, was there a surplus?

Mr. GOULD. I believe there was a surplus for the last fiscal year.

Mr. RUSSO. How much was it?

Mr. GOULD. I cannot—I would be happy to get you that number.

Mr. RUSSO. Could you furnish that number to me?

Mr. GOULD. Yes, sir.

[The information follows:]

The Old Age and Survivors Insurance Trust Fund had a net increase in total assets of $3,642,078,000 for fiscal 1986. The Disability Insurance Trust Fund had a

net increase during the same period of $2,475,409,000. However, the Disability increase was due entirely to repayment to Disability of money previously borrowed by Old Age. The Social Security Board of Trustee Annual Report predicts that Disability will run a deficit in 1987.

Mr. RUSSO. Okay, thank you.

Mr. DORGAN. Mr. Chairman.

Mr. GRADISON. Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Dorgan and then Mr. Gradison.

Mr. DORGAN. Thank you, Mr. Chairman. Mr. Gould, I would like to ask you a couple of questions. I guess I do not address them so much to you as I do rhetorically to the President. I am wondering why I should vote for an extension or an increase in the debt ceiling.

This administration, for as many years as I have served on this committee, has gotten involved in a fiscal policy vehicle and gone for what I consider a reckless drive. At the end of the drive the administration comes back to our pumps and says, fill it up. Why do I have a responsibility, as a member who fundamentally disagrees with the fiscal policy of this administration, to, at the end of each year to say, yes, you are right, we have a responsibility to fill up your tank?

I finished reading David Stockman's book just in the last week or two, and it confirms what I have been concerned about, that this fiscal policy is rooted in deception. That it is now rooted in intransigence as well, that is, no new revenue. We insist on increasing spending in the biggest account.

I want to ask you a question, and this is not meant as disrespect for you. I have great respect, incidentally, for Secretary Baker and you, personally. But I do not respect this administration's fiscal policy. What do you say to someone like me who says, why should I be responsible to fill up your tank?

Mr. GOULD. Let me try to give you a candid answer, sir.

Mr. DORGAN. All right.

Mr. GOULD. I do not think there is merely an administration problem. The deficit that we are financing—and that is what we are doing here—has been created as a function of the budget passed by Congress and signed by the President. It is in my view, a joint undertaking. And we are talking about things that have been passed.

We are spending money that has been appropriated by Congress. And in asking you to increase the debt limit, we are asking you to give us the wherewithal, the mechanism to finance the appropriated expenditures. And that is item one.

Item 2, whether or not you like the idea of refilling the tanks, I think you also have the responsibility—not you personally, but the Congress generally—of not putting this country into default with the horrendous consequences for the citizens of this country that would result from such a default.

Mr. DORGAN. I understand that point, and I am not unmindful of the danger to our Government as a result of the refusal of Congress to clean up the mess here. I do not suggest Congress does not have some responsibility in this. But you say that you ask us for these things, and we ask the administration to cooperate with us.

We need new revenue. There is not anyone whom I know, whom I respect a great deal, who does not understand that structurally you need additional revenue to solve this deficit problem. When we talk with the administration about the need for compromise on that, we are told to forget it. I guess I just have great difficulty trying to figure out why year after year we ought to keep saying, yes, you bet, sure, we are willing to cooperative with you.

On fundamental issues of fiscal policy this administration says to Congress, absolutely not, we will not budge an inch. In fact they say more than that, the President says go ahead and make my day. That simply does not square with me. It is not responsible. You are asking us to be responsible, and I think we have to be responsible.

Mr. GOULD. I am asking you to take the responsibility of giving us, the Treasury, the means to finance the budget which Congress passed. And without this we do not have the ability to fulfill the budget which has been passed by the Congress.

Mr. DORGAN. I understand that and we will assume that responsibility, I will bet. But I would also hope that you will take a message back to this administration. We hope this administration would meet its responsibility to compromise with Congress on some fundamental changes that are necessary in our fiscal policy.

We need new revenue. Having just finished Mr. Stockman's book, you become furious at the deception in which this fiscal policy is rooted. We have got to change course. I hope for some cooperation from the administration.

Let me emphasize again, as far as I am concerned, Secretary Baker and you are fine people and I respect the work you do. But I do not respect the fiscal policy of this President, and I hope for some cooperation some time soon. The administration asks us to fill up its tank, and essentially tells us to go take a hike when we talk about the serious part of how to solve a long-term fiscal problem. I do not like it.

Chairman ROSTENKOWSKI. Mr. Gradison.

Mr. GRADISON. Thank you, Mr. Chairman.

Mr. Secretary, I was disappointed by your response to Mr. Gibbons' question with regard to sequestration. I understand the administration wants a clean debt bill. They always want a clean debt bill. But we did not get a clean debt bill last year, that is where Gramm-Rudman came from. And we may get something like that again.

Now from the point of view of the House of Representatives, operating under our rules, which probably will give you a clean debt bill from the House but not from the Senate, we run the risk of being left out of this process unless we give some early thought to possible alternatives.

Therefore, I would very much appreciate it if you could respond to us in a timely way in writing with regard to methods of reconstituting the sequestration mechanism which would be constitutional.

I am not asking whether you are for them or against them. I met with Secretary Baker, I know he does not want us to tack anything onto this bill. But if we do tack something on, the question of how to write it in a constitutional manner is critical.

The probable approach will be to involve the Office of Management and Budget in the place of the General Accounting Office in

some manner, or perhaps to have a bill that would reach the President like any other bill, subject to his approval or disapproval.

But I would specifically ask this question, Mr. Secretary. Could you respond to this committee within the next week in writing with regard to an analysis of methods which the administration feels would be constitutional methods of reconstituting the sequestration mechanism under the deficit reduction bill, Gramm-Rudman-Hollings?

Mr. GOULD. I would be happy, sir, to go back to the Treasury and find out what we can do for you in that respect.

Mr. GRADISON. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Can the Chair get an indication from the members of who would like to inquire? Are there any other questions?

Mr. GREGG. Could I inquire of the Chair? Do you have a timeframe for when you feel that we are going to be bringing up this piece of——

Chairman ROSTENKOWSKI. We will probably start marking up the debt ceiling next week.

Mr. GREGG. Thank you.

Chairman ROSTENKOWSKI. To be more specific, maybe Tuesday. But according to our whip notices, we are going to have a full week next week, and a full week the following week because of the Department of Defense authorization bill.

If there are no further questions, I want to thank you, Mr. Secretary, for joining us this morning. I want you to know I will be meeting later on in the day to talk with the Secretary of Treasury about this.

Mr. GOULD. All right, sir.

Chairman ROSTENKOWSKI. The committee stands adjourned.

[Whereupon, at 10:03 a.m., the hearing was adjourned.]

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